BRIEF IN SUPPORT OF PETITION

This is an application for a writ of certiorari for a review of the decree of the United States Circuit Court of Appeals for the Third Circuit, affirming a decree of the United States District Court for the Western District of Pennsylvania, approving a plan for the reorganization of a bankrupt.

The material facts and questions involved are set forth in the foregoing Petition.

The questions for decision are:

(1) Whether (as the Committee-Appellant contends), Universal's property should have been valued on earnings, and the refusal to so value was error requiring reversal,

(a) "The basic question in valuation in reorganized purposes is how much the enterprise in all probability can earn" (*Fed. Power Com.* v. *Hope Nat'l Gas Co.*, 320 U. S. 591, 602, Note 9). *Citing Group of Institution Investors* v. *C. M. St. P. & P. R. R. Co.*, 318 U. S. 523).

(a) No exception is made by this Court to its requirement that the valuation be on earnings, since, if left to the discretion of the Lower Court, the requirement would be abrogated:—The Lower Court would overrule this Court on a question as to which this Court is most insistent,—such a result would be revolutionary.

(b) Here, not alone, is there no adequate reason for refusal to value on earnings, but there are most compelling reasons for so valuing.

A valuation on earnings is based on the Debtor's prospects, and in refusing to value on earnings here the Court

overrules a most accomplished and experienced witness, the Chief Engineer of the Gulf Oil Corporation, the Master and the Trustee on a business,—not a legal,—question, since they all contend that the prospects of the corporation are most promising. Yet the knowledge of the Court below was far less than that of the witness, the Master and the Trustee.

One of the two grounds for refusal to value on earnings,—viz., that the future market will be less than that created "under the highly artificial stimulus of war production", was conclusively shown baseless.

The only other ground is that "an unusually favorable tax situation" existed in 1944 and is answered by the fact that Congress is now preparing and will doubtless pass a tax bill which will permit small business to earn a fair profit.

The tax credit for 1944 was about $70,000 and as the earnings were over $150,000, a net profit of over $80,000 would have remained if the tax had been required to be paid, and as the debts amount to only $400,000 and the dividends at

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NOTE I. "The commercial value of property consists in the expectancy of income from it. Such criterion is the one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. It is plain that valuations for other purposes are not relevant to or helpful in a determination of that issue, except as they may indirectly bear on earning capacity. The criterion of earning capacity is the essential one." *Consolidated Rock Co.* v. *Dubois*, 312 U. S. 510, 526.

"The Supreme Court has several times said that the best test of the value of a going commercial enterprise is its earning capacity." *Galveston H. & S. R. Co.* v. *Texas*, 210 U. S. 217, 226; *Consolidated Rock Products Co.* v. *Dubois*, 312 U. S. 510, 525, 526; *Group of Institutional Investors* v. *Chicago M. St. P. & P. R. Co.*, 318 U. S. 523, 540; *Dudley* v. *Mealey*, 147 F. 2d 268.

"That this earning capacity was something in addition to the value of the tangible property sought to be taken." *Puget Sound Power & Light Co.* v. *City of Puyallup*, 51 F. 2d 688. 51 F. 2d 694.

"A sum of values based on physical factors and assigned to separate units of the property without regard to the earning capacity of the whole enterprise is plainly inadequate (*Consolidated Rock Co.* v. *Dubois*, 312 U. S. 510, 526)."

6% would amount to only $24,000, the profit remaining would not alone have paid these dividends in full, but have left approximately $60,000 to redeem preferred stock or be paid to the common stockholders.

The witness, the Master and the Trustee all knew and must have given due weight to war demand and taxes, yet they agreed that the Corporation's prospects are most promising. *This Court had no new facts on which to base refusal.*

The Court below erred in seeking to cast doubt on the showing that the Trustee has already largely replaced and will completely replace obsolete machines with new ones which will produce, with no added expense, 5½ times the production of the outmoded and antiquated machines, but the proof was clear and from it the conclusion is inevitable that previous earnings will be greatly increased in the future.

The Court below states that the Corporation lost money from 1932 to 1941, in every year but one, and says that the Special Master stated that the losses may have been due to litigation with Stewart-Warner, though he did not so find. It is stated in the Plan itself that,

"That litigation extending over a number of years has occasioned the expenditure of a great amount of money" (Plan p. 4), "and Kalish, the attorney, states that the Debtor lost $2,000,000 through Stewart-Warner's unfair competition" (App. 125a, 130a). So the loss from 1932 to 1941 would have been a profit but for this unfair competition and is not a recurring loss or one due to the business. This allegation and admission is nowhere disputed and is conclusive (3 Jones on Evidence, 2d Ed. § 1005, p. 1847). The Company earned $151,008.42 in 1943, and $124,046.56 in 1944, and figuring the $2,000,000 lost through unfair competition as profit for the nine (9) years from 1932 to

1941 would make an average profit of over $200,000 per year.

The failure to value on the earnings constitutes a highly material error, because at the earned rate of $150,000 a year (and not taking into account the greatly increased earnings which will come from new machinery), Debtor's business would be worth $1,650,000 using 11 times the net earnings as a yardstick. (*Puget Sound Power & Light Company* v. *Puyallup*, 51 F. (2) 688, 694).

(2) The reasons hereinabove stated for granting a writ as Nos. 2, 3 & 6, being for refusal to value the Debtor's claim against Brynoldt or the coupler or the claim against Stewart-Warner, will be combined as to the general law, applicable to all of them, and the special arguments applicable to each of them will be stated separately.

The Court Below simply "extinguished" these three claims by refusing to give them any value.

Any difficulty or uncertainty as to the value of the Stewart-Warner and the Brynoldt claims is no excuse for failure to value them, and there is no difficulty or uncertainty as to the value of the coupler patent. "Consolidated makes some point of the difficulty and expense of determining the extent of its liability * * *. The fact that the claim might be settled, with the approval of the Court, after full disclosure and notice to interested parties, does not justify the concealed compromise effected here through the simple expedient of extinguishing the claim" (as is done to Stewart-Warner, the patent claim and the Brynoldt claim). *Consolidated Rock Co.* v. *Dubois*, 312, U. S. 510, 522, 523.

A

There are the following special reasons why the Stewart-Warner claim should have been valued and why it was error to refuse to value it,—

(1) The Trustee states in the Plan,

> "That litigation extended over a number of years has occasioned the expenditure of a great amount of money * * * but recent decisions have been favorable to Debtor and there is every reason to expect that there will be a substantial recovery by the Debtor's Trustee * * *" (Plan, top p. 4).

The Plan, the Trustee's pleading and the allegation quoted is conclusive evidence that Debtor will make "a substantial recovery". (Jones on Evidence, 2nd ed. sec. 1005, p. 1847).

(2) The District Court has authorized the Trustee to continue this litigation (July M.R. Para. 20, p. 32 a; Oct. M.R. Para. IV, p. 72 a), and holding that this claim is so valuable that the stockholders' money must be expended to litigate it, is a conclusive answer to a holding that it has no value in determining solvency.

(3) The attorney in this case states that he can prove liability "up to the hilt" (127 a), and that the Debtor lost $2,000,000 (125 a, 126 a, 130 a) through unfair competition. There is no evidence to the contrary. So, on the proof Debtor is entitled to recover $2,000,000 and the presumption in equity is that it will recover the amount due it (30 C.J.S. sec. 104 p. 506); and as the Stewart-Warner acts were wrongful, only the best proof available will be required (*Eastman Co.* v. *So. P. Co.*, 273 U. S. 359).

Both the District Court of the Circuit Court of Appeals recognize the strong probability, if not certainty, that there will be "a substantial recovery" by providing how the amount of it will be distributed.

B

The claim against Brynoldt for the damages arising from baseless assertion of title was a clear one and the refusal to value it was error.

The Court below mistakenly held that this claim for slander of title arose from the Reclamation Petition filed after Debtor had been declared a bankrupt, and that Brynoldt had the right to assert title in that, whereas the baseless claim of title was in exacting a Bill of Sale and a lease simultaneously, and thereby for a long period claiming title to all of the Debtor's property and necessarily ruining what credit it had left after its ruinous litigation with Stewart-Warner.

"The Trustee believes that there is but remote possibility that Brynoldt could sustain his claim to absolute ownership (July M.R. Para. 25, p. 34 a)."

This is a conclusive admission that Brynoldt's claim of title was baseless. (Jones on Evidence, 3rd edition, Sec. 272, p. 405). Moreover, Universal was encumbered with debt and equity will relieve on account of the advantage taken and hardship inflicted (*U. S.* v. *Bethlehem Steel*, 315 U. S. 328, 329).

This baseless claim by Brynoldt was prejudicial in a pecuniary sense to Debtor, who was engaged in trade and, therefore, constituted actionable libel (*Pollard* v. *Lyon*, 91 U. S. 308, 310).

As Brynoldt required an absolute Bill of Sale for the loan of money, which was calculated to invite and result in fraud and injustice this act constituted a quasi-fraud (Waite on Fraudulent Conveyances and Creditors Bills, 3 ed. sec. 404, p. 736), and as the slander of title was gross, deliberate and wilful, and a reckless disregard of Debtor's rights, Universal is entitled to exemplary damages (37 C.J.S. sec. 144, p. 489).

C

As appears last above under B. Brynoldt's claim to title of the coupler patent was baseless and Debtor remains as against him the owner of the patent. Its value was

proved by the Trustee to be $40,000 and it was plain error to refuse to value it at that sum, and the error was vital on the question of solvency because of the very slight excess claimed to exist of liabilities over assets. (Oct. M.R. Para. 4, p. 62 a; Para. 8, p. 64 a).

D

The allowance of Brynoldt's claim of $29,316 for rental of the Debtor's property so far departs from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

Under "B" above, we have shown that Brynoldt had no title to Debtor's property, in that his attempt to secure $327,000 worth of property for $20,000 was so unconscionable that equity will relieve from the Bill of Sale (*U. S.* v. *Bethlehem Steel*, 315 U. S. 328); Brynoldt then had no title to the property he sought to give a lease of,—he simply attempted to lease Debtor what remained and always was its own property. There was, therefore, no foundation whatever for the allowance by the Master, the District Judge and the Court Below of $29,316 for rental, and with the issue concededly close as to solvence, the error was vital.

More than that, the allowance of this rental certainly does so far depart from the accepted and usual course of judicial procedure and from fair and just treatment as to call for this Court's power of supervision, and to have it stamp this transaction, as it is, unconscionable.

E

For the reasons stated in the Argument as to the refusal to value the Brynoldt claim and on the allowance of the Brynoldt claim for rental, the refusal to permit a suit to be brought against Brynoldt for recovery of the

damages through his unfounded and prolonged claim of title, and the resulting injury to the Debtor's credit so far departs from the accepted and usual judicial procedure as to call for this Court's supervision.

F

The provision in the Plan whereby the creditors receive all the stock of the reorganized company, except what, if any, may be sold, and that the proceeds of the Stewart-Warner suit shall be used to pay, if sufficient, the Preferred shares of the reorganized company in full will result, if sufficient money is realized from the Stewart-Warner suit to pay these Preferred creditors in full, in their being so paid in full, and in their being made a present and a gift of all the Debtor's other property, concededly worth $327,000 (aside from the Stewart-Warner claim, the coupler patent and the Brynoldt claim), which is flagrantly unjust, and the power to make such a gift goes beyond the jurisdiction of the Courts Below. This is so serious and vital an error as to alone clearly call for the exercise of this Court's power of supervision.

G

The eighth reason for certiorari is that the rulings of the Master in his two reports, approved by the District Judge and the Circuit Court of Appeals, in the aggregate constituted such departure from accepted and usual course of judicial procedure as to call for this Court's power of supervision. This is made plain by the fact that the real issue is whether Universal is solvent and whether the correct determination of any of the questions specified would have not necessitated a ruling that the corporation is solvent.

(1) The decision below is in direct conflict with the repeated holdings of this Court that valuation must be on

earnings. Not alone is there no excuse for the refusal to value on earnings, but facts produced required such a valuation. If the rule of this Court is to be observed, the decision of the court below must be reversed.

(a) In nine years debtor lost, thru unfair competition, $2,000,000, over $200,000 a year, a non-recurrent loss not due to the business, but for which there would have been a corresponding profit.

(b) During the 3½ years of the Trusteeship the earnings have averaged $60,000 a year, two and a half times the amount needed for dividends to the creditors.

(c) For the last two years the earnings have averaged $135,000 a year, over five times what will be needed for dividends.

(d) In three and a half years part of debtor's tangible assets have grown from $63,909.16 to $327,000, an increase of about $263,091, and it would take at the present rate of earning about 5 years to pay the creditors their claims of $397,000.

(e) The best qualified witnesses procurable, the Master and the Trustee, asserted that the outlook of debtor is most promising. There is no evidence to the contrary.

(2) If the rule pronounced by this Court, that all a debtor's property must be valued in determining solvency is to be observed, the decision below must be reversed. In conflict with this rule, the Court below extinguished three big, substantial claims.

(a) Debtor lost $2,000,000 thru unfair competition by Stewart-Warner. Liability can be proved up to the hilt. The litigation has been carried on many years, at large expense to the stockholders. Both courts below recognize

its value by providing for distribution of its proceeds. Yet, the court below refused to value it.

(b) The patent has a proved present value of $40,000, yet the Court below refused to value it.

(c) The Brynoldt rental claim of $29,316 is glaringly, indisputably so invalid that the Trustee admits that there is but remote possibility of Brynoldt establishing the absolute ownership necessary to make the claim valid, yet the court below held this wholly bad claim valid.

(d) It is obvious that debtor must have been severely damaged and handicapped by Brynoldt's prolonged and baseless claim of title, and that the damages must have been large, yet the court below refused to value it.

(e) Making Brynoldt the favorite of the reorganization by giving him three directors, and him alone of the unsecured creditors, a large cash payment, is unfair, inequitable and prejudicial to the stockholders.

II

Lastly, it is urged that this litigation has a public interest which should influence the decision of all of the issues involved in it, in that the enforcement of the anti-monopoly statutes is of vital importance to the Country, and it would be clearly hindered if the decree below were affirmed, for that would be noted to all manufacturers that, if anyone of them single-handedly and courageously fought a monopoly to a successful result, but in doing it became unable to pay their debts at once, although he had his business and a claim against the monopolist for large damages, all that he has remaining, except what remains of these damages after paying his creditors in full, will be taken from him and made a gift to his creditors in addition to their being

paid in full. Such a prospect would certainly deter any careful or thoughtful man from striving to enforce the right of all citizens to competition and would result in his acquiescing in what is recognized as one of the real ills and dangers of the capitalistic system.

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